

Message Text

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ACTION EB-07

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P 101830Z FEB 76

FM AMEMBASSY SAN JOSE

TO SECSTATE WASHDC PRIORITY 2818

INFO AMEMBASSY GUATEMALA

AMEMBASSY MANAGUA

AMEMBASSY PANAMA

AMEMBASSY SAN SALVADOR

AMEMBASSY TEGUCIGALPA

USDEL MTN GENEVA

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E.O. 11652: N/A

TAGS: ETRD, MTN, CS

SUBJECT: MTN: CONCESSIONS FROM COSTA RICA IN TROPICAL
PRODUCTS NEGOTIATIONS

REF: STATE 6095

GUATEMALA FOR ROCAP (BY POUCH)

1. SUMMARY. THIS MESSAGE DESCRIBES THE COMPLEX SYSTEM
OF TARIFFS AND SURCHARGES AFFECTING IMPORTS IN COSTA RICA
AND SUGGESTS CONCESSIONS THAT MIGHT BE SOUGHT FROM COSTA RICA.
IT CONCLUDES THAT THE BEST APPROACH MIGHT BE TO SEEK REDUCTIONS
IN INTERNAL CONSUMPTION TAXES, WHICH IN THE CASE OF MANY
PRODUCTS DISCRIMINATE AGAINST IMPORTS AND IN FAVOR OF PRODUCTS

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ASSEMBLED LOCALLY OR WITHIN THE CACM. IT ALSO RECOMMENDS AN

ATTEMPT TO NEGOTIATE A REDUCTION IN THE 30 PERCENT SURCHARGE THAT ALL CENTRAL AMERICAN COUNTRIES HAVE BEEN APPLYING SINCE 1968 TO IMPORTS FROM OUTSIDE OF THE CACM AND A REDUCTION OF THE CACM'S COMMON EXTERNAL TARIFF FOR CERTAIN NON-SENSITIVE ITEMS WITH A HIGH PRICE ELASTICITY OF DEMAND.
END SUMMARY.

2. THE EMBASSY REGRETS THE DELAY IN RESPONDING TO REFTEL WHICH WAS OCCASIONED BY THE VERY COMPLEXITY OF THE SYSTEM OF TAXES THAT COSTA RICA NOW LEVIES UPON IMPORTS AND THE CONSEQUENT DIFFICULTY OF IDENTIFYING WHAT KINDS OF CHANGES IN THAT SYSTEM MIGHT REPRESENT USEFUL CONCESSIONS TO THE U.S.

3. COSTA RICA SHARES WITH THE OTHER MEMBER COUNTRIES OF THE CENTRAL AMERICAN COMMON MARKET (CACM) A COMMON EXTERNAL TARIFF ON MOST PRODUCTS, AS WELL AS A 30 PER CENT SUR-CHARGE IMPOSED ON THOSE RATES IN 1968 IN THE "PROTOCOL OF SAN JOSE". FOR BALANCE OF PAYMENTS REASONS, COSTA RICA HAS IMPOSED ON TOP OF THESE RATES TWO ADDITIONAL SYSTEMS OF SURCHARGES. THE FIRST, CALLED THE "SELECTIVE CONSUMPTION TAX" WAS FIRST IMPOSED IN MARCH 1972. RATES WERE SHARPLY INCREASED IN 1975 AND 1976. MOST PRODUCTS WHICH ARE DEEMED TO BE LUXURY PRODUCTS OR NON-ESSENTIALS ARE SUBJECT TO 50 PER CENT TO 100 PER CENT CONSUMPTION TAXES, IF IMPORTED, AND TO SOMEWHAT LOWER RATES TENDING TO FALL INTO THE 10 PER CENT TO 25 PER CENT RANGE IF THE PRODUCTS ARE MANUFACTURED OR ASSEMBLED LOCALLY OR WITHIN THE CACM.

4. THE SECOND SYSTEM OF SURTAXES, WHICH BECAME EFFECTIVE IN JANUARY 1976, CONSISTS OF "TEMPORARY IMPORT SURTAXES" OF FROM 10 PER CENT TO 50 PER CENT ON A NUMBER OF IMPORTED NON-ESSENTIAL PRODUCTS.

5. THE PROBLEM OF SEEKING CONCESSIONS FROM COSTA RICA IS FURTHER COMPLICATED BY THE COUNTRY'S VERY DIFFICULT BALANCE OF PAYMENTS SITUATION WHICH HAS BEEN AMPLY DESCRIBED IN SEVERAL EMBASSY MESSAGES WHICH ARE BEING PASSED TO MTN GENEVA. EMBASSY AGREES WITH ROCAP AND WITH EMBASSY GUATEMALA THAT IT WILL BE DIFFICULT TO NEGOTIATE SUBSTANTIAL REDUCTIONS IN THE COMMON EXTERNAL TARIFF AND THE 30 PER CENT PROTOCOL OF SAN JOSE
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SURCHARGE BECAUSE OF THE BALANCE OF PAYMENTS DIFFICULTIES OF COSTA RICA AND MOST OTHER CACM COUNTRIES. WE BELIEVE, HOWEVER, THAT THE 30 PER CENT SURCHARGES ON TOP OF THE ALREADY HIGH COMMON EXTERNAL TARIFF RATES RESULT IN A MARGIN OF PROTECTION AGAINST IMPORTS THAT IS EXCESSIVE AND ENCOURAGES LOCAL ASSEMBLY INDUSTRIES, MANY OF WHICH HAVE A VERY LOW VALUE ADDED, TO CHARGE EXCESSIVE PRICES. WE BELIEVE, THEREFORE, THAT AN EFFORT TO NEGOTIATE ELIMINATION OF THE 30 PER CENT

PROTOCOL OF SAN JOSE SURCHARGE MIGHT BE WARRANTED EVEN IF THE CHANCES OF SUCCESS APPEAR TO BE SMALL.

6. IN THE CASE OF COSTA RICAN TAXES AFFECTING IMPORTS THE EMBASSY DOES NOT BELIEVE THAT NEGOTIATING FOR REMOVAL OR REDUCTION OF "TEMPORARY IMPORT SURTAXES" (DESCRIBED IN PARA 4 ABOVE) WOULD BE CONSISTENT WITH THE PURPOSES OF THE MTN AS THESE SURTAXES WILL PRESUMABLY BE REMOVED VOLUNTARILY WHEN COSTA RICA'S BALANCE OF PAYMENTS SITUATION IMPROVES. IF THEY ARE REMOVED VOLUNTARILY, THIS MIGHT WELL OCCUR BEFORE CONCESSIONS NEGOTIATED IN THE MTN WOULD GO INTO EFFECT. ON THE OTHER HAND, THE COSTA RICAN GOVERNMENT HAS IN THE PAST PROVED TO BE EXTREMELY RELUCTANT TO REMOVE TAXES ONCE THEY ARE IMPOSED. MOREOVER, THE PROCEEDS FROM THESE "TEMPORARY IMPORT SURTAXES" ARE BEING SUED TO FINANCE PROGRAMS OF EXPORT EXPANSION, INCLUDING SUBSIDIES TO EXPORTS, THAT THE GOVERNMENT MAY BE RELUCTANT TO TERMINATE. THEREFORE, IT MIGHT BE REASONABLE TO SEEK A COMMITMENT FROM THE COSTA RICAN GOVERNMENT THAT THE SURTAXES WHICH IT HAS DESCRIBED AS TEMPORARY WILL INDEED BE REMOVED AS SOON AS WARRANTED BY THE BALANCE OF PAYMENTS SITUATION.

7. UNLIKE IMPORT SURTAXES, THE SELECTIVE CONSUMPTION TAXES (DESCRIBED IN PARA 3 ABOVE) HAVE NOT BEEN SPECIFICALLY IDENTIFIED AS TEMPORARY AND MAY WELL BE RETAINED INDEFINITELY. AS THE CONSUMPTION TAX RATES ON MANY ITEMS ARE VERY HIGH AND TEND TO BE MUCH HIGHER FOR MOST GOODS IMPORTED FROM OUTSIDE OF THE COMMON MARKET THAN FOR THOSE PRODUCED DOMESTICALLY OR WITHIN THE CACM, THESE TAXES MIGHT WELL BE THE BEST TARGET FOR THE U.S. TO FOCUS ON IN ASKING FOR CONCESSIONS FROM COSTA RICA. OF THE PRODUCTS TAXABLE INTERNALLY AT DIFFERENTIAL RATES THAT DISCRIMINATE AGAINST THE U.S. AND OTHER NON-CACM COUNTRIES, ONE THAT WOULD APPEAR TO OFFER A GOOD OPPORTUNITY TO INCREASE THE U.S. MARKET SHARE, AND WHICH MIGHT ALSO BE EASIEST TO LIMITED OFFICIAL USE

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NEGOTIATE IS AUTOMOBILES.

8. THE MARKET FOR U.S. AUTOMOBILES HAS BEEN SEVERELY RESTRICTED BY CONSUMER TAXES THAT APPLY ALMOST PROHIBITIVE RATES TO MEDIUM SIZE AND LARGE CARS, WHETHER IMPORTED IN KNOCK-DOWN FORM AND ASSEMBLED HERE OR IMPORTED ALREADY ASSEMBLED. ASSEMBLY OF U.S. CARS HAS VIRTUALLY CEASED AND THE MARKET IS BEING RAPIDLY TAKEN OVER BY SMALL JAPANESE AND EUROPEAN MODELS. WE SEE ALMOST NO HOPE OF NEGOTIATING ANY CHANGES THAT WOULD RESTORE THE COMPETITIVE POSITION OF MIDDLE TO LARGE SIZE AMERICAN CARS (IN U.S. TERMS "COMPACTS" AND LARGER MODELS), BECAUSE OF THE STRONG DETERMINATION OF THE COSTA RICAN GOVERNMENT TO SEVERELY RESTRICT LUXURY IMPORTS AND PETROLEUM CONSUMPTION. AS ANY FUTURE CHANGES IN THE COSTA RICAN TAX SYSTEM WILL BENEFIT MAINLY SMALL CARS, THE

EMBASSY BELIEVES THAT THE U.S. EFFORT IN THE AUTOMOTIVE FIELD SHOULD BE TO SEEK CHANGES IN THE COSTA RICAN TAX SYSTEM THAT WOULD PLACE NEW U.S. "SUB-COMPACT" MODELS ON AN EVEN COMPETITIVE BASIS WITH JAPANESE AND EUROPEAN MODELS.

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9. THE MAJOR CHANGE NEEDED IN THE CONSUMER TAX ON AUTOMOBILES IS TO CHANGE THE ENGINE DISPLACEMENT CEILING SO THAT SMALL U.S. MODELS WILL BE ABLE TO QUALIFY FOR THE LOWER TAXES THAT ARE NOW AVAILABLE ONLY FOR CERTAIN JAPANESE AND EUROPEAN CARS. AT PRESENT, IMPORTED CARS, AND ANY LOCALLY-ASSEMBLED CARS HAVING AN ENGINE DISPLACEMENT GREATER THAN 1300 CC'S MUST PAY A 100 PER CENT CONSUMER TAX AND MUST ALSO BE PAID FOR IN CASH. A LOCALLY-ASSEMBLED CAR UNDER THE 1300 CC'S LIMIT QUALIFIED FOR A LOWER 55 PER CENT CONSUMPTION TAX RATE AND CAN BE PURCHASED ON CREDIT. THE TAX RATE ON CARS UNDER 1300

CC'S MAY BE PROGRESSIVELY REDUCED AS COSTA RICA'S BALANCE OF PAYMENTS SITUATION IMPROVES. RAISING THE ENGINE DISPLACEMENT CEILING TO 1500 CC'S WOULD PERMIT U.S. SUB-COMPACTS SUCH AS THE NEW CHEVETTE AND COMPARABLE MODELS THAT WILL BE INTRODUCED BY OTHER U.S. MANUFACTURERS, TO COMPETE ON EQUAL LIMITED OFFICIAL USE

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TERMS WITH JAPANESE AND EUROPEAN MODELS. GIVEN THE LOWER FREIGHT COSTS FROM THE U.S. AND THE PREFERENCES HERE FOR U.S. GOODS, WE BELIEVE THAT U.S. AUTOMOBILES COTMND RECOVER A SUBSTANTIAL PORTION OF THE MARKET UNDER SUCH CONDITIONS. AS THE LOCAL AUTOMOBILE ASSEMBLY INDUSTRY USES COMPLETE VEHICLES SHIPPED FROM THE FACTORY IN "KNOCKED-DOWN" FORM, A CONCESSION ON VEHICLES ASSEMBLED FROM U.S. COMPONENTS WOULD BE A VALUABLE ONE AND WOULD BE EASIER TO NEGOTIATE THAN A CONCESSION ON FULLY ASSEMBLED VEHICLES, WHICH WOULD COMPETE WITH THE LOCAL ASSEMBLY INDUSTRY.

10. THEREFORE, THE EMBASSY WOULD RSMOMMEND NEGOTIATING FOR AN INCREASE IN THE ENGINE DISPLACEMENT CEILING NEEDED TO QUALIFY FOR THE LOWER 55 PER CENT RATE OF NLNSUMPTION TAX FROM 1300 CC'S TO 1500 CC'S, AND PERHAPS ALSO FOR A DECREASE IN THE RATE ITSELF. WE ESTIMATE THAT THE U.S.#1(COULD DO \$500,000 WORTH OF BUSINESS HERE WITH THE 1500 CC LIMIT. IF THE LIMIT WERE PUSHED TO 1700 CC, ADDITIONAL U.S. MODELS LARGER THAN THE NEW "SUB-COMPACT" CATEGORY SUCH AS PINTO COULD QUALIFY FOR REDUCED TAXES, BUT BECAUSE THE PINTO REPORTEDLY CONTAINS MANY MAJOR PARTS OF NON-U.S. ORIGIN (ENGINE, TRANSMISSION, ETC.) THE VALUE IN INCREASED U.S. EXPORTS OF PUSHING BEYOND 1500 CC MIGHT BE NEGLIGIBLE. ALSO IT WOULD BE HARDER TO CONVINCE THE GOCR TO GO TO 1700 CC, AS 1500 CC CAN MORE EASILY BE PORTRAYED AS A LOGICAL DIVIDING LINE BETWEEN SMALL AND MEDIUM SIZE CARS IN THE NEW ERA OF HIGH GASOLINE PRICES.

11. THERE ARE OTHER PRODUCTS ON WHICH THE U.S. MIGHT WANT TO NEGOTIATE FOR A REDUCTION IN THE DIFFERENTIAL RATE FAVORING THE CACM PRODUCT OVER THE IMPORTED IN COSTA RICA'S SELECTIVE CONSUMPTION TAX SYSTEM. SOME REPRESENTATIVE EXAMPLES ARE:

ITEM AND QNJ	TAX RATES ON
NAUCA CODE	IMPORTS CACM PRODUCTS

HARDWARE (LOCKS)	30 P.C. 15 P.C.
699.18	

PAINTS, VARNISHES, ETC	50 P.C. 10 P.C.
533.03	

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TARPAULINS, TENTS, SAILS, ETC 50 P.C. 30 P.C.
656-02-00

TOTAL 1974 IMPORTS (FROM U.S.)

HARDWARE, LOCKS \$2,550.38
699.18 (\$1,022.92)

PAINTS, VARNISHES \$1,364,974
ETC. 533.03 (\$733,820)

TARPAULINS, TENTS \$55,240
SAILS, ETC (\$21,149)
656-02-00

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12. THE GENERAL NEGOTIATING APPROACH THAT THE U.S. SHOULD FOLLOW IN THE MTN NEGOTIATIONS WITH COSTA RICA SHOULD BE TO CONCENTRATE ON LOWERING DUTIES AND INTERNAL TAX DIFFERENTIALS ON CONSUMER GOODS, BUT AVOIDING ITEMS THAT ARE OF A LUXURY NATURE IN FAVOR OF ITEMS THAT HAVE SOME RECOGNIZABLE UTILITARIAN VALUE, AT LEAST IN SOME USES. GIVEN THE BALANCE OF PAYMENTS PROBLEM AND THE GOVERNMENT'S DETERMINATION TO REDUCE NON-ESSENTIAL IMPORTS, SUMPTUARY ITEMS WILL ONLY BE NEGOTIABLE IF THEY CAN BE PORTRAYED AS SERVING SOME WORTHY PURPOSE, SUCH AS OUTBOARD MOTORS FOR FISHERMEN OR CALCULATORS FOR STUDENTS. AS FOR CAPITAL EQUIPMENT AND INDUSTRIAL RAW MATERIALS OR SEMI-FINISHED MATERIALS OR ANY INDUSTRIAL INPUTS THERE WOULD SEEM TO BE LITTLE REASON TO SEEK OR ACCEPT CONCESSIONS IN THOSE AREAS, AS SUCH IMPORTS ARE FREE FROM CONSUMPTION TAXES AND MOST LOCAL INDUSTRIES ALSO HAVE TARIFF FREE TREATMENT FOR THE INPUTS USED IN THEIR PROCESSES.

13. NEGOTIATING REDUCTIONS IN THE CACM COMMON EXTERNAL TARIFF MIGHT BE DIFFICULT AS OTHER CACM POSTS HAVE POINTED OUT, BUT WE BELIEVE THAT IT SHOULD BE POSSIBLE TO DEVELOP A REASONABLE CONCESSIONS LIST WITHOUT THREATENING THE BALANCE OF PAYMENTS POSITION OF THE CACM COUNTRIES. TWO ITEMS THAT OCCUR TO US WHERE IMPORTS MIGHT INCREASE SIGNIFICANTLY IN RESPONSE TO A LIMITED OFFICIAL USE

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PRICE REDUCTION WOULD BE ELECTRONIC CALCULATORS AND OUTBOARD MOTORS.

14. ELECTRONIC CALCULATORS AND ADDING MACHINES (NAUCA 714-02-03) ARE SUBJECT TO A 30 PERCENT COMMON EXTERNAL TARIFF AND, IN COSTA RICA, TO A 15 PERCENT CONSUMPTION TAX (WHICH IS THE SAME FOR IMPORTS AND CACM-PRODUCED ITEMS, IF ANY). IMPORTS IN 1974 TOTALLED \$835,887, OF WHICH \$158,232 CAME FROM THE U.S. IT MIGHT BE POSSIBLE TO NEGOTIATE A LARGER TARIFF REDUCTION IN THE MORE EXPENSIVE MACHINES, WHERE THE U.S. COMPETITIVE POSITION IS PROBABLY STRONGER, BY EMPHASIZING THEIR USE BY BUSINESSES AND STUDENTS AS COMPARED TO CHEAPER MACHINES USED AS CONSUMER PLAYTHINGS.

15. OUTBOARD MOTORS (NAUCA 711-05-03) ARE SUBJECT TO A 20 PER CENT COMMON EXTERNAL TARIFF, AND, IN COSTA RICA, PAY NO CONSUMPTION TAX. THE U.S. ENJOYS A DOMINANT POSITION IN THE COSTA RICAN MARKET HAVING SUPPLIED \$372,148 WORTH OF TOTAL IMPORTS IN 1974 OF \$405,735 (92 PER CENT OF THE MARKET). AS WE KNOW OF NO PRODUCTION WITHIN THE CACM, AND THE ITEM CAN BE PORTRAYED AS A CAPITAL GOOD FOR THE SMALL FISHING INDUSTRY, THE CHANCES OF NEGOTIATING A REDUCTION IN DUTIES MIGHT BE GOOD. TODMAN

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